

Romania



BUSINESS FORUM
LONDON 22-24 APRIL 2001

Investment Profile

2001



Held on the occasion of the
EBRD ANNUAL MEETING



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This document was drafted by the EBRD Country Promotion Programme team assisted by Bank staff and the Romanian authorities. It was prepared with information available up to March 2001, derived principally from the EBRD, the EU, Reuters, the EIU and the World Bank. Every effort has been made to ensure accuracy. However, no responsibility is accepted for the contents of this document.

ISSN 1470-3963



Foreword

The past 10 years have demonstrated that transition is not a fast forward march along a straight road, but a challenging process, more complex and difficult than many had imagined.

However, Romania has over recent years undergone substantial political and economic transformation, designed to establish a free-market economy through privatisation of state-owned enterprises and deregulation of the economy.

The road ahead is of course not an easy one. The new government that took office in December 2000 intends to build on the Medium-Term Economic Strategy presented last year to the European Union, to continue with prudent macroeconomic policies and to enhance structural reforms.

The economy has already returned to growth after three years of recession, the external position has been further consolidated, inflation has decreased, industrial output has picked up, domestic demand has begun to recover, and market confidence has continued to improve. Following these achievements, Romania is well positioned to establish a solid basis for a rapid and sustainable economic growth. In order to reach this goal and to make it lasting, the Government's priorities are to reduce inflation, to speed up structural reform, including specific and rapid action in the area of privatisation, mainly related to the large loss-making state-owned enterprises, and to support the large-scale investment process. In this respect, the Government has already initiated the privatisation process for 17 companies under PSAL (the second wave of another 20 companies will follow in April-May) and has taken action to create a comprehensive and coherent fiscal legislation, converting the existing legislation in the tax area into four main laws.

EU and NATO membership remain major priorities for the new Government, which is aware that progress toward EU accession will require a constructive and cooperative relationship with the IMF. Preliminary discussions with the IMF in anticipation of negotiations for a new stand-by credit agreement began in February.

In this context, the support of the EBRD remains of major importance. Romania currently ranks third in terms of signed contracts, with loans and equity investments amounting to € 1,643.8 million. During the past decade, your esteemed institution has proved to be a committed partner playing an active role in promoting the private sector and in facilitating investment, and we look forward to mutual cooperation between the two parties continuing in the future.

Mihai Nicolae Tanasescu

Minister of Public Finance

EBRD Governor for Romania

Introduction



The Romanian economy has returned to growth after three consecutive years of economic recession. The country also made successful efforts to strengthen macroeconomic stability in 2000. In December 2000, a new centre-left government took office, which has pledged to continue the programme for EU accession, to further advance economic reforms and fiscal discipline and is under strong pressure from international institutions (especially the IMF, the World Bank and the EU) to do so. The continuation of enterprise restructuring, the acceleration of privatisation and improvement of the regulatory and supervisory environment in the financial sector are the central issues to be addressed in order to sustain macroeconomic and financial stability and economic recovery in Romania.

Political and economic transition

Romania started its transition to democracy and a market economy in December 1989. In the period between 1989 and 1996, the country was led by a centre-left president, Ion Iliescu, and the successive governments were formed by centre-left parties. Romania initiated a gradual reform of the economy and established democratic institutions.

Between 1996 and 2000, the country was governed by a centre-right coalition (made up of the Democratic Convention (DC), the Social Democratic Union (SDU) and Hungarian Democratic Union in Romania (HDUR)) and reformist president Emil Constantinescu. The government started with the acceleration of economic reforms in its first years and achieved some success in accelerating large-scale industry and bank privatisation, and in closing down a number of major loss-making enterprises in the coal and metallurgical sectors. However, the reforms did not deliver the desired results, as Romania experienced a second major transition recession that saw GDP fall by a cumulative 14 per cent in real terms between 1997 and 1999.

Following the November 2000 parliamentary elections, the centre-left Party of Social Democracy in Romania (PSDR) formed a minority government with Adrian Nastase as Prime Minister. The PSDR has signed a co-operation agreement with the Hungarian Democratic Union in Romania (HDUR) and the National Liberal Party (NLP). Ion Iliescu, who had already served as president from 1989 to 1996, won the presidential election held at the same time. The Nastase government has pledged to improve the economy by offering tax cuts to businesses, to fight corruption, reduce government bureaucracy, provide a more stable political environment and increase social protection. The new government is also a firm supporter of Romania's integration into Euro-Atlantic structures, particularly the EU and NATO.

Challenges met, challenges ahead

Following three years of recession, Romania managed to return to economic growth in 2000. The growth was largely driven by exports and industrial sector output growth, with some additional support from domestic investment. However, inflation remained high and the fiscal position relatively vulnerable. Future macroeconomic stability will depend to a certain extent on the government's success in securing a stand-by agreement with the IMF that is currently under negotiations. An agreement with the IMF would also enable Romania to draw upon further funding available from the EU and the World Bank.

The Romanian economy is dominated by industry and agriculture. Industry's share of GDP at constant 1989 prices fell from 40 per cent in 1989 to an estimated 27.6 per cent in 2000, due to restructuring and decline, especially of heavy industry. The share of services, at an estimated 46.6 per cent of GDP in 2000, lags behind that of other transition economies, but is expected to grow over the long term. The estimated share of agriculture was 11.4 per cent of GDP in 2000. Agriculture has been a main provider of employment for workers who became redundant as a result of industrial restructuring. (See *Major sectors of the economy* below.)

The private sector now accounts for around 62 per cent of GDP and around half of employment. The privatisation of mainly small and medium-sized enterprises, retail units and small farms has progressed relatively well. However, many of the large industrial enterprises and the utility sector are still in state hands. A commitment to speed up the privatisation and restructuring of industry was a main pledge of the new government's economic programme. The privatisation process was re-launched towards the end of February, when the government initiated the privatisation of 17 companies included in the PSAL 1 programme agreed with the World Bank. Large enterprises also listed for

privatisation are Petrom, the national oil company; Alro, a highly profitable aluminium smelter; Tarom, the national air carrier; and six major tourism companies. The government has indicated that the privatisation of these companies will be launched following the initial wave of 17 companies. The privatisation of Sidex Galati, the largest and a very successful metallurgical company, has been launched. The deadline for the submission of bids is 14 April 2001. (See *Major sectors of the economy* below.)

The need to attract foreign capital for the restructuring of industry, public utilities and the financial sector remains a major task in Romania. Foreign investment into the country has been rather low to date, with a net total of only around US\$ 6.5 billion by the end of 2000. However, some sectors, such as telecommunications or the car industry, have managed to attract some major foreign investors that have contributed significantly to the modernisation efforts. (See *Investment climate* below.)

The subsidisation of loss-making enterprises represents a large burden for the Romanian budget, although restructuring in certain sectors has made progress. Enterprise losses were cut to some extent during 1999 and 2000, because of the accelerated closure of loss-making coal mines, increases in administered prices and the suspension of operations in some large industrial enterprises. However, Romania is still confronted with huge inter-enterprises and budget arrears, which have been forecast at some 40 per cent of 2000 GDP on a gross basis.

Romania is in need of major investments and restructuring to improve its infrastructure. The government has pushed through some restructuring in the energy sector, as strategies were prepared for the sale of the distribution subsidiaries of former CONEL, the state-owned electricity monopoly. In addition, an independent gas sector regulator was established in January 2000 and the natural gas monopoly ROMGAZ was broken up in May 2000. An encouraging start has been made in 1998 in the telecommunications sector, with the partial privatisation of the national fixed-line company, RomTelecom, and the launch of several infrastructure investments. (See *Major sectors of the economy* below.)

In recent years, Romania has achieved significant progress in restructuring and improving the performance of the banking sector. Key among the measures taken was the closure in 1999 of Bancorex, which accounted for two thirds of the losses of the banking system, and the placing of Banca Agricola, the second largest state bank, under special supervision. Banca Agricola is currently undergoing privatisation negotiations, which should result in its sale by the end of March 2001. Preparations for the privatisation of Banca Comerciala Romana, Romania's largest commercial bank, planned to take place in 2001, are also under way. Accelerating the privatisation of state-owned banks and continued enhancement of banking regulations and supervision would bring further improvements to the sector. (See *Financial sector* below.)

International relations

The major priorities of Romanian foreign policy are EU and NATO membership. (See *EU integration* below.) Romania participates in NATO's Partnership for Peace Programme and the government has been pursuing an ambitious programme to secure Romania's place in the next round of NATO enlargement. In 2001 the country holds the OSCE (Organisation for Security and Co-operation in Europe) chairmanship, one of the most important international tasks for Romania in decades.

Romania also strives to contribute to regional stability and actively participates in regional co-operation forums. Romania is a member of the Stability Pact for South-Eastern Europe. The Pact supports countries of the region including Romania in their efforts to foster peace, democracy, and respect for human rights and economic prosperity. Romania is also to benefit from projects, mainly in the infrastructure sector, that are funded by international financial institutions under the umbrella of the Stability Pact.

In terms of regional economic integration, Romania is a member of the Central European Free Trade Agreement (CEFTA), along with Bulgaria, the Czech Republic, Hungary, Poland, Slovakia and Slovenia. The country is also a member of the Central European Initiative (CEI) and the Black Sea Economic Co-operation. Relations with Hungary, previously tense because of disagreements over the treatment of minorities, have also greatly improved.

EU Integration

Diplomatic relations between the European Union (EU) and Romania began with the Europe Agreement (EA), which was signed in February 1993. Following this, Romania's official request for accession to the European Union was presented in June 1995. After the Helsinki European Council meeting at the end of 1999, the Council decided to start accession talks with Romania in the spring of 2000. As an immediate task before the start of the negotiations, Romania had to demonstrate the smooth implementation of existing short-term adjustment programmes agreed with the IMF, the World Bank and the EU.

The Nice Summit held in December 2000 has endorsed the EU's road map towards enlargement and re-shaped the structure of the main EU institutions (the Council of Ministers, the European Parliament and the Commission) accordingly. The final outcome has been generally favourable to all the central and eastern European countries, including Romania. It was established that Romania would have 14 votes in the Council of Ministers, 33 seats in the Parliament and one Commissioner in the Commission.

Romania is benefiting from three pre-accession instruments financed by the EU: the PHARE programme; SAPARD, which provides aid for agricultural and rural development (See *Major sectors of the economy: Agriculture* below.); and ISPA, which finances infrastructure projects in the fields of environment and transport (See *Major sectors of the economy: Transport* below). In the years 2000-02 total financial assistance to Romania will amount annually to at least € 242 million from PHARE, € 153 million from SAPARD, and between € 208 and € 270 million from ISPA.

The highest allocations of funding under the PHARE programme during 2000 were for the following items:

- Support to assist energy sector liberalisation, the inter-bank payments system and securities market regulation;
- Twinning, technical assistance and investment in the areas of the internal market, agriculture, central banking, public finance and statistics; and
- Investment support to regional development programmes.

During the EU accession negotiations, Romania had closed six of the 31 negotiation chapters by the end of 2000. The latest Progress Report on Romania was published in November 2000 and the main issues identified in the document are as follows:

Progress

- Modest economic growth.
- Improved functioning of the judiciary.
- Law on the civil service adopted.
- Some progress in macroeconomic stabilisation.
- Exports have increased.
- Continued to advance with the adaptation to EU law.

Progress yet to be made

- Progress on reforming state-owned economy must be accelerated.
- Living conditions in orphanages must be improved.
- Agricultural reform needs to progress.
- The level of corruption needs to be reduced.
- Discrimination against the Roma minority needs to be fought.
- The police and other bodies subordinated to the Ministry of Interior should be demilitarised.
- The country cannot yet be regarded as a functioning market economy.
- The country is not able to cope with competitive pressure and market forces within the EU in the medium term.
- Steps are needed to improve its future economic prospects.

For the full text of the latest EU Progress Report on Romania and other enlargement related information see:

www.europa.eu.int/comm/enlargement/romania/index.htm

Information on the PHARE programme is available on the EU Commission's web site:

www.europa.eu.int/comm/enlargement/pas/phare/index.htm



Economic summary



Romania witnessed a mainly export and domestic demand-led economic recovery during 2000. GDP has grown by 1.6 per cent, following three consecutive years of decline, and is forecast to expand in 2001 by 4.1 per cent. However, the growth was paralleled by higher than targeted results for inflation and the fiscal deficit, as a result of policy slippage in the areas of state sector wages and domestic arrears. The new government that took office in December 2000 has promised to further economic reforms and fiscal discipline in 2001, and is under strong pressure from the international financial institutions to do so.

GDP growth

Following three years of recession, the Romanian economy recorded a positive growth rate of 1.6 per cent in 2000. The rise in GDP was driven by industrial output growth and strong foreign exports, on the back of strong EU demand. Real GDP growth of 4.1 per cent is forecasted for 2001. Future growth will highly depend on domestic demand and, in particular, the capacity to stimulate new investments. Exports are expected to grow more slowly in 2001, compared with 2000, as EU demand moderates.

Inflation

Year-end inflation for 2000 was down to 40.7 per cent from 54.8 per cent in 1999, but well above the end-2000 government target of 27 per cent. The overshooting of the inflation target was primarily caused by three shocks: a severe drought that pushed food prices up (thereby adding more than 20 per cent of the initial CPI target), the increase in world oil prices, and faster depreciation of the domestic currency against the US dollar in order to compensate in part for the weak euro. Wage growth (some of it related to poor financial discipline) also contributed to inflationary pressures.

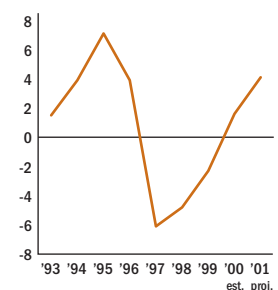
Romania is likely to manage to reduce inflation in the coming years, with year-end inflation falling to 25 per cent in 2001 and annual average inflation to around 32 per cent. The country's Medium-Term Economic Strategy for EU Accession targets single-digit inflation rates by the end of 2004. An easing of international oil prices and greater euro stability should contribute to a gradual reduction in inflation rates in 2001 and in the coming years. However, the inflation rates for 2001-02 will depend critically on the size of the budget deficits and on success in reaching an agreement with the IMF, which will help Romania to finance the fiscal and current account deficits.

Current account

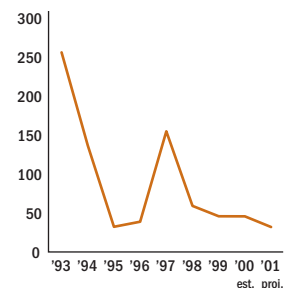
Romania has managed to achieve a significant improvement in its current account balance in the last two years, as the current account deficit dropped from US\$ 2,968 million in 1998 to US\$ 1,296 million in 1999 and then rose only slightly to US\$ 1,400 million in 2000. The positive trend has largely been the result of good export performance, as imports declined to 12 per cent in 1999, but grew over 20 per cent in 2000.

In 2001, the government is expected to run a slightly larger current account deficit of around 4.5 per cent of GDP. The projected higher deficit is based on slower export growth (7 per cent in 2001 as opposed to 22 per cent in 2000) and higher imports caused by a forecasted pick-up in domestic investment. FDI inflows and foreign borrowings are likely to cover the increased deficit. In addition, prudent macroeconomic and fiscal policies promise to keep domestic demand in control.

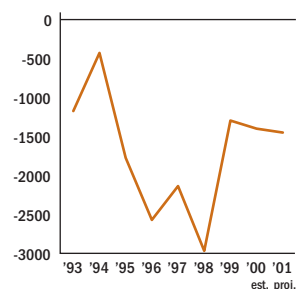
GDP
% change



Consumer prices
Annual average, % change

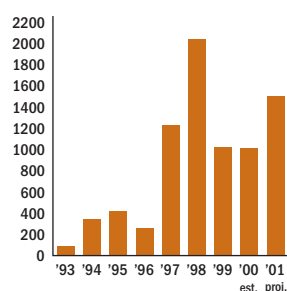


Current account
US\$ millions

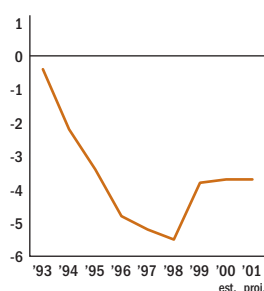


Source: National Bank of Romania, Ministry of Development and Prognosis and National Institute of Statistics and Economic Studies, March 2001

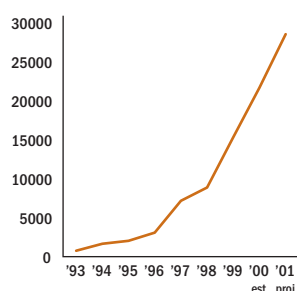
Total FDI
US\$ millions, net



General government balance
% of GDP, excluding privatisation proceeds



Exchange rate
Annual average, lei per US\$



Source: National Bank of Romania, Ministry of Development and Prognosis and National Institute of Statistics and Economic Studies, March 2001

Foreign Direct Investment

After a peak of around US\$ 2 billion in 1998, FDI receipts fell back to around US\$ 1 billion in 1999 and an estimated US\$ 1 billion in 2000. The low figure for 2000 is attributable to the wait-and-see approach of foreign investors ahead of the elections held in November 2000 and the removal of customs duty and tax incentives for foreign investors in 1999. FDI inflows may rise in 2001, provided the new government delivers its policy commitments to accelerate privatisation and improve the business climate. (See *Investment climate* below.)

Government balance

The Romanian government ran relatively large budget deficits in 1997 and 1998, but in 1999 the deficit was slightly reduced. In 2000, the general government deficit amounted to 3.7 per cent of GDP, as opposed to 3.8 per cent of GDP in 1999. The initial government target for 2000 was a 3 per cent deficit. However, in September the government had to approve a supplementary budget revising the consolidated budget deficit target to 3.5 per cent of GDP. A slight overshoot in expenditures on state-sector wages and non-compliance with the targeted employment cuts were responsible for the higher deficit.

For 2001, the government has proposed a budget deficit of 3.7 per cent of GDP. However, the IMF regards a budget deficit of closer to 3 per cent of GDP as the desirable outcome of fiscal policy for 2001. Romania is still in discussion with the IMF in order to reach an agreement.

Exchange rate

The National Bank of Romania's (NBR) strategy during 2000 was to allow the nominal exchange rate to depreciate in line with inflation, to maintain a stable real exchange rate. Indeed, the leu depreciated on average by 41.5 per cent during 2000, compared with an average inflation rate of 45.7 per cent, resulting in a real depreciation of the leu against the US dollar of less than 1 percentage point over the period. However, the leu fell by only 22.3 per cent against the euro over the same period, resulting in a significant real appreciation of the leu against the euro of about 16.5 per cent. In 2001, the central bank aims at an exchange rate policy which will help to preserve export competitiveness and at the same time avoid adding to inflationary pressures. Therefore, given prevailing economic conditions, the nominal exchange rate is forecast to depreciate roughly in line with inflation, with a modest projected real appreciation of 2-3 per cent in CPI terms over the entire year.

IMF agreements

The December 2000 report on the IMF Article IV Consultation noted that Romania has made significant progress in stabilisation and reform in the last two years. Corrections in the fiscal accounts and the exchange rate in 1999 helped to narrow the current account deficit to a sustainable level and averted an imminent financial crisis. Urgently needed measures to restructure the banking system were also adopted, and the privatisation process was accelerated. However, this good record was jeopardised in the second part of 2000 (ahead of the elections) by policy slippages in the areas of domestic arrears and wages in the state sector, which contributed to significantly higher-than-targeted inflation. The IMF warned Romania that progress in disinflation and consolidation of the external position will require wage and financial discipline in the state-owned enterprises, continued fiscal consolidation, and prudent monetary policy. Such policies need to be accompanied by strong reform measures – accelerated restructuring of the enterprise and banking sectors and an improvement of the business environment.

Romania secured a US\$ 547 million stand-by facility from the IMF in August 1999, drawing US\$ 73 million immediately and another US\$ 116 million last June, when the agreement was renewed and extended until February 2001. By June 2000 Romania had complied with all the IMF-agreed criteria relevant for that period, with the exception of arrears. However, a third tranche worth US\$ 112 million was not released, on the grounds that the government had missed some of the targets set out in its spring budget and agreed with the Fund.

Romania is currently in the process of negotiating a new stand-by agreement with the IMF. Reaching an agreement with the IMF would be important in strengthening Romania's financial credibility. It would help Romania to receive further funding from the World Bank and the EU, and to borrow from private capital markets. Romania has successfully re-entered the sovereign debt market and borrowed around € 455 million between October 2000 and January 2001 for three- and five-year maturities. A new issue of Eurobonds worth € 300-400 million is expected to be concluded in the forthcoming period.

EU convergence issues

The latest EU progress report on Romania welcomed the fact that the country has made some progress on macroeconomic stabilisation. However, according to the report, Romania cannot yet be regarded as a functioning market economy. The EU acknowledged that the economy has returned to growth after three years of recession and that the macroeconomic environment has improved. The government was also praised for its relatively tight fiscal policies. The report stressed the need for increased fiscal discipline, the continuation of sectoral reforms, especially in agriculture, and the acceleration of legal harmonisation.

Credit ratings

Standard & Poor's sovereign ratings, February 2001

Local Currency			Foreign currency		
Long-term	Outlook	Short-term	Long-term	Outlook	Short-term
B	Positive	C	B-	Positive	C

Moody's country ceilings for foreign currency ratings, January 2001

Bonds and notes		Bank deposits	
Long-term	Short-term	Long-term	Short-term
B3	NP	Caa1	NP

Fitch IBCA foreign currency sovereign ratings, January 2001

Long-term	Short-term
B	B

Selected economic indicators									
	1993	1994	1995	1996	1997	1998	1999	2000 est.	2001 proj.
GDP (% change)	1.5	3.9	7.1	3.9	-6.1	-4.8	-2.3	1.6	4.1
Consumer prices (annual average % change)	256.1	136.7	32.3	38.8	154.8	59.1	45.8	45.7	32
Current account (in US\$ millions)	-1,174	-428	-1,774	-2,571	-2,137	-2,968	-1,296	-1,400	-1,450
General government balance (% of GDP) excluding privatisation proceeds	-0.4	-2.2	-3.4	-4.8	-5.2	-5.5	-3.8	-3.7	-3.7
Trade balance (in US\$ millions) FOB/FOB	-1,128	-411	-1,577	-2,471	-1,980	-2,625	-1,092	-1,684	-1,250
Total FDI (in US\$ millions, net)	87	341	417	263	1,224	2,040	1,025	1,009	1,500
External debt stock (US\$ millions)	4,249	5,563	6,482	8,345	9,503	9,899	9,095	9,917	na
Unemployment (% of labour force)	10.4	10.9	9.5	6.6	na	10.4	11.5	10.5	9.9
Exchange rate, annual average, lei per US\$	760	1,655	2,033	3,083	7,168	8,875	15,333	21,693	28,550
Gross reserves, excluding gold and SRD (end-year, US\$ millions)	40	536	278	547	2,090	1,374	1,516	2,469	3,200

Source: National Bank of Romania, Ministry of Development and Prognosis and National Institute of Statistics and Economic Studies, March 2001

Investment climate



The investment framework in Romania began to improve under the outgoing administration and is expected to continue to improve under the new government that took office in January 2001. Several important measures were taken in 1999-2000 to address issues such as corruption, excessive red tape and a poor regulatory system that are major obstacles to attracting foreign direct investment (FDI). Foreign investors were compensated for the abolition of discretionary incentives with the introduction of major tax cuts in corporate tax, VAT and excise duty. The new government is also planning to implement an ambitious privatisation schedule in 2001.

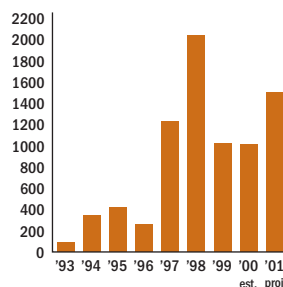
Foreign direct investment

FDI inflows have played an important role in managing the balance of payments and in starting to modernise some economic sectors in recent years. Net inflows rose most steeply in 1996 and 1997, reflecting early international enthusiasm for the new centre-right government. FDI then significantly increased in 1998 and 1999 as well, boosted by the privatisation of Romtelecom, the national fixed line monopoly, and Renault's purchase of car maker Dacia. Renault (France) received a number of incentives from the government, including a five-year exemption from profit tax, customs duties and VAT on imported inputs and technology, and a three-year lag in VAT payment on cars sold in Romania. Later, foreign investment incentives were suspended and replaced with general tax cuts, following an agreement with main IFIs.

FDI inflows in 2000 were slightly down (net US\$ 1,065 million), compared with 1999 (net US\$ 1,102 million), reflecting foreign investors' caution about the outcome of the parliamentary and presidential elections held in November 2000. The new government that took office in January 2001 made pledges to improve the investment climate.

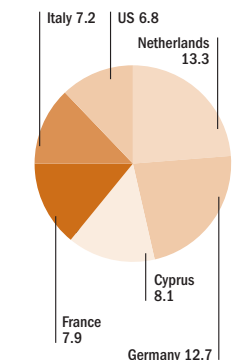
Romania's main advantages as an investment destination include a potentially large domestic market of 22 million customers (the second largest in central Europe after Poland), a good geographical position, a wide range of natural resources

Total FDI
US\$ millions, net



Source: National Bank of Romania
March 2001

FDI by countries of origin
December 1990-August 2000



Source: National Commission for Statistics

(large reserves of oil, gas and minerals), a diversified industrial structure, skilled labour and low wages.

Preferred areas for foreign investment include:

- oil exploration: investors include Shell (UK-Netherlands), BP Amoco (UK), or Occidental (US), and oil and gas distribution with investors such as Agip (Italy), MOL (Hungary), Lukoil (Russia), OMV (Austria) and Ruhrgas/Wintersall (Germany);
- the automobile and automotive component industry: investors include Renault (France), Daewoo (South Korea), Siemens (Germany), and Daimler Benz (Germany);
- banking and finance: investors include Societe Generale (France), ABN Amro Bank (Netherlands), Citibank (US), ING Barings (Netherlands), Alfa Bank (Greece), CAIB (Austria) and Raiffeisen (Austria);
- telecommunications: investors include France Telecom (France), OTE (Greece), and Airtouch-Vodafone (UK);
- commercial construction and development: investors include Lafarge (France), Bouygues (France), Heidelberger (Germany), and Holderbank (Switzerland);
- hotels: investors/operators include Hilton (US), Holiday Inn (US), Compagnie Immobiliere Phoenix (France), Ilbau Holding (Austria), Marriott (US) and Best Western (US);
- consumer products: investors include Procter and Gamble (US), Henkel (Germany), Colgate-Palmolive (US); and
- retail sector: investors such as Metro (Germany), Carrefour (France) and Billa (Austria).

Concerning future potential, the volume of FDI inflows will be determined by the new government's success in accelerating the privatisation process and improving the investment climate. The privatisation of companies under the PSAL I and PSAL II programme is planned to be continued in 2001. The list of largest assets to be sold includes the national airline, two major metallurgy companies, the national oil company and six major tourism companies (See *Privatisation and restructuring* below). In addition, regulatory changes introduced in 1999 and changes in the tax regime in 2000 are certain to have a positive effect on investment inflows.

Investment policy and incentives

Romania has worked to create a legal framework consistent with a market economy and investment promotion. Gradually it has been moving to strengthen tax administration, enhance transparency and create legal means to reach expeditious resolution of contract disputes. In May 1999 the government enacted a package of legislation approved by the World Bank that addressed many of the failings in Romania's legal framework concerning private enterprise.

Romanian legislation provides for foreign investors to be granted national treatment, have free access to domestic markets, and be able to participate in privatisation. There is no limit on foreign participation in commercial companies. Foreign investors are entitled to establish wholly foreign-owned enterprises in Romania (although joint ventures are the normal pattern). They are allowed to participate in the management and administration of the investment, as well as to assign their contractual obligations and their rights to other Romanian or foreign investors.

Following an agreement with main IFIs, in 1999 the government suspended the investment incentives provided to large foreign investors in order to ease budgetary constraints. This move established an equal fiscal regime for both Romanian and foreign investors. As a compensation for the loss of incentives, a generally applied tax reform was introduced in early 2000, including cuts in corporate tax, VAT and excise duty. (See *Taxation and social expenditure* below.)

Although discretionary incentives for foreign investors have ceased, Romania's free-trade zones all offer customs and tax incentives. The incentives include unrestricted entry and re-export of goods as well as exemption from customs duties and value added tax. They also include an exemption from profit taxes for the duration of a company's operations in the free trade zones. Currently, there are six free trade zones:

- Sulina (located at the mouth of the Danube);
- Constanta-Sud (located close to the port of Constanta, at the entrance to the Black Sea-Danube canal);
- Galati (located about 100 kilometres from the mouth of the Danube);
- Braila (located 30 kilometres up the Danube from Galati);
- Curtici-Arad (located about 30 kilometres from the border with Hungary); and
- Giurgiu (located on the Danube, 60 kilometres south of Bucharest).

There are also concessions made in "disadvantaged zones" (regions with high unemployment due to heavy restructuring) including: full restitution of import duties for depreciable goods; exemption from profit tax; exemption from any fees associated with the re-zoning of agricultural land for industrial purposes; and access to a special development fund for stimulating exports, guaranteeing external credits, financing special programmes and state-sponsored equity investments.

In 2000, important measures were taken in the fight against corruption, which had been a serious concern among investors. A new law was introduced on preventing and uncovering corruption within public institutions and banks, directed above all at officials who take part in decision-making or are able to influence it in some way.

Foreign investors may freely repatriate profits and dividends in hard currency. Proceeds from the sale of bonds, shares, or other securities can also be repatriated. There is no limitation on the inflow or outflow of funds for remittances of profits, debt service, capital gains, returns on intellectual property or imported inputs.

In the area of capital movements and payments, the implementation of the three-stage liberalisation programme, approved by the National Bank of Romania in July 1999, made progress in 2000. The National Bank of Romania has continued to relax controls on capital transfers. However, there are still restrictions remaining on capital imports and exports.

The purchase of real estate by non-nationals is forbidden by the Constitution. There is an exception for companies established in Romania, even if wholly foreign-owned, which are allowed to purchase land needed for the conduct of their business.

Taxation and social expenditure

Important tax reforms, geared towards lowering tax rates, broadening the tax base and reducing distortions, took effect in early 2000.

The main tax changes are:

- the corporate income tax rate was reduced from 38 per cent to 25 per cent. (A more favourable tax rate of 5 per cent is applied for profits stemming from export activities.);
- a new global personal income tax law has been introduced, in force as of January 2000;
- a new uniform VAT rate of 19 per cent has replaced the previous reduced rate of 11 per cent and standard rate of 22 per cent;
- excise duty rates were revised, and they are still at a lower level than minimum rates in the EU, combined with the enlargement of the excise duty base; and

- the road tax was increased from 25 per cent to 45 per cent, with proceeds to fund the modernisation of Romania's road network.
- Romania achieved some progress with **pension reform** in 2000. In April 2000 a new law on public system pensions and other social security benefits was passed, which is to be implemented starting from April 2001. At present the pension system includes three elements: (i) a publicly managed pay-as-you-go defined benefit plan, (ii) a contributory supplemental retirement plan; and (iii) a mostly non-contributory programme for farmers. The current pay-as-you-go pension system is faced with growing difficulties owing to declining employment, accumulated debts to the social security budget and failure to pay contributions. A three-pillar system, proposed by the pension reform, will consist of a public pay-as-you-go system, a mandatory privately managed second pillar and a voluntary third pillar. The new law introduces reforms in the first pillar, including the raising over a period of 13 years of the minimum retirement age, from 62 for men and 57 for women to 65 for men and 60 for women.

Privatisation and restructuring

The privatisation law adopted in the middle of 1999 attempted to simplify and unify earlier regulations relating to the privatisation, restructuring and liquidation of enterprises. The privatisation process continued during 2000, with the sale of 19 large companies, 908 SMEs and 348 companies where the state held a less than 33 per cent stake. The privatisation process itself was partly interrupted by the general and presidential elections of November 2000. Following its election, the new centre-left government reorganised the State Ownership Fund, a previously semi-autonomous organisation, forming the new Agency for Privatisation and Management of State Ownership (APAPS). The Agency was brought under the direct control of the government, and is being headed by the Minister responsible for privatisation. The government intends to introduce a number of new, tighter rules regarding the preservation of the privatised company's core business for five years following privatisation, as well as maintaining company turnover at a minimum 70 per cent of turnover during the year preceding privatisation. In the interest of accelerating the privatisation process, a self-declared priority for the new government, towards the end of February the Agency announced the imminent launch of the privatisation of 17 companies that were originally targeted for privatisation through the PSAL 1 Agreement. The government has indicated that the privatisation process for these companies will be transparent. In addition, the government is committed to the privatisation of a number of large state owned companies of national/strategic interest including the following:

- Petrom, the national oil company;
- Sidex Galati, the largest and a very successful metallurgical company;
- Alro, a highly profitable aluminium smelter;
- Tarom, the national air carrier; and
- six major tourism companies.

(See Major sectors of the economy below for more details.)

The privatisation process is therefore currently proceeding through three main channels:

- privatisation/liquidation through sales agents under the PSAL 1 Agreement;
- direct sales of state enterprises by the Agency for the Privatisation of State Assets (APAPS); and
- privatisation of national companies (former regies autonomes).

In terms of successful privatisations to date, the sale of Romtelecom to OTE (Greece) and the carmaker, Dacia, to Renault (France), were the two largest enterprise privatisations involving a foreign investor. Other important privatisation deals include the sale of Astra Vagoane, the largest railway carriage producer, to Trinity (US) in 1999 and the purchase of a 51 per cent stake in Santierul Naval Galati, a Danube based shipyard, by Damen Shipyards (Netherlands), also in 1999. In the financial sector two Romanian banks have been successfully privatised so far. During 1998, the Romanian Bank for Development (BRD) was sold to Societe Generale (France), and Banc Post was acquired by a consortium including Banco Portugues de Investimento (BPI, Portugal). Subsequently, during 2000, EFG Eurobank (Greece) took a participation in Banc Post alongside BPI. The privatisation of two large state-owned banks, Banca Agricola (BA) and the Romanian Commercial Bank (BCR), is in progress. (See *Financial sector* below.) The subsidisation of loss-making enterprises represents a large burden for the Romanian government budget, although restructuring in certain sectors has made progress. Enterprise losses were cut somewhat between 1998 and 2000, because of the accelerated closure of loss-making coal mines, increases in administered prices and the temporary suspension of operations by two refineries and a few large metallurgical plants after they lost access to foreign financing.

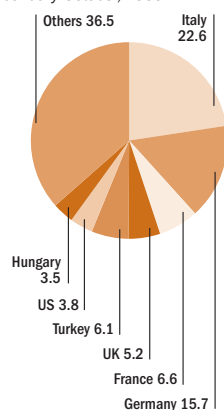
Major reforms of the power and gas sectors are underway. CONEL, the national electricity company, has been broken up into five independent entities and strategies have been prepared for the sale of its distribution and generation subsidiaries. Natural gas monopoly Romgaz was also broken up in May 2000, as part of its re-structuring process. The gas distribution business segment is also being considered for privatisation. A major study on the restructuring of the Romanian steel industry, in line with EU requirements, was approved by the government at the beginning of July 2000.

(See *Major sectors of the economy* below.)

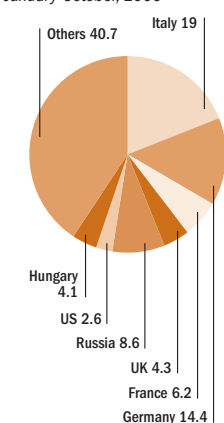
Markets and trade

Romania is a founding member of the World Trade Organisation and has adapted its commercial policy in conformity with the rules and commitments of the Uruguay round. The most important trade agreement for Romania is its Association Agreement with the EU, which came into force in 1995. Romania has liberalised merchandise trade asymmetrically: the EU had abolished all duties and ceilings on manufactured goods by 1997, whereas Romania does not have to do so until 2002. Romania is also a member of the Central European Free Trade Agreement (CEFTA), since July 1997. CEFTA aims for the gradual establishment of a free trade zone for industrial products by 2002, and the liberalisation of trade for agricultural products. Other CEFTA members are Bulgaria, the Czech Republic, Hungary, Poland, Slovakia and

Exports by country
January-October, 2000



Imports by country
January-October, 2000



Source: General Customs Directorate

Slovenia. Romania has agreed to establish a free-trade area in manufactured goods with Bulgaria and Turkey by 2002.

In observation of these trade agreements, the government implemented a large-scale reduction in tariffs with effect from 1 January 2001. Import tariffs on products, with the exception of agricultural products, from the EU, CEFTA and EFTA (European Free Trade Agreement) have been cut by 80 per cent. From January 2002 tariffs will be lifted completely on all industrial imports from these countries.

The EU is Romania's main trading partner and accounts for more than two-thirds of total exports and imports. Trade relations with neighbouring countries are rather underdeveloped, but has registered a sharp rise since Romania joined CEFTA. Russia is an important source of energy and raw materials, but insignificant as an export market.

Low value-added, labour-intensive products made by the clothing, footwear and furniture industries constitute the largest product categories of exports. Other important export goods are metallurgical products and electric machinery and appliances. Re-exports under outward-processing arrangements account for a large share of trade. Imports are largely concentrated on machinery and equipment from OECD countries, energy and raw materials from Russia and the developing countries, and textiles and other materials from the EU linked to outward-processing arrangements. Imports of mineral fuels were reduced in recent years, largely as a result of falling demand for energy as a result of the restructuring of the iron and steel industries, and the general fall in industrial output.

Major sectors of the economy



The Romanian economy is dominated by industry and agriculture. Industry's share of GDP fell from 40 per cent in 1989 to an estimated 27.6 per cent in 2000, due to restructuring and decline, especially in heavy industry. However, some sectors, such as telecommunications and the car industry, managed to start successful restructuring with the help of foreign direct investment. The share of services, at an estimated 46.6 per cent of GDP in 2000, lags behind that of other transition economies, but is expected to grow over the long term. The estimated share of agriculture was 11.4 per cent of GDP in 2000.

Metallurgy

The metals sector is the most important segment of Romanian industry, as it accounts for about 15 per cent of industrial production and around 5 per cent of the country's GDP. Following a long and comprehensive restructuring process, the sector is recovering from recession and showed signs of output and export growth in 1999 and 2000. In parallel, the privatisation of several plants, among them the largest steel producer, Sidex, and the largest aluminium producer, Alro, gained momentum in the second part of 2000.

The restructuring of the sector, which started in 1993, involved downsizing and also significant modernising with investments targeting cost reduction, energy savings and development of higher-value-added products. The sector's workforce has been reduced: the number of employees fell by around 50,000 between 1990 and 1998, leaving 120,000 in place in early 1999.

These efforts have started to bring positive results, as Romania's metals output and exports were on an upward trend throughout 1999 and 2000. In the first half of 2000, the sector expanded by 11 per cent year-on-year. Sales abroad have been always vital for the industry, and export performance has also improved. Exports of metallurgy products have soared in value to US\$ 712 million, compared with US\$ 550 million in the first nine months of 1999. Romania exports about 40 per cent of its metal output and the metal sector accounts for up to 10 per cent of Romanian exports. Around 40 per cent of foreign sales go to the EU countries.

The sector is predominantly state-owned, but several privatisation deals with the involvement of foreign capital have taken place. The first steel mill acquired by a foreign investor was Otelinor. In 1997, Samsung (South Korea) bought a 51 per cent stake in the Otelinor plant located in Targoviste. The plant produces stainless steel plates and wires, and concrete steel. More recently, in June 2000, a consortium of Noble Ventures (US), Alternative Finance and SIIF Energies (both France) agreed to buy the state's 94.5 per cent stake in the Combinatul Siderurgic Resita steel mill. The investors paid US\$ 85.25 million for the factory and pledged to bring new technology that will enable the plant to produce high quality steel products targeting the US and European markets.

Alro

Aluminium maker Alro is the most successful and prosperous state owned company in Romania, as well as the largest aluminium producer in central and eastern Europe, the seventh largest in Europe and the nineteenth in the world. Alro is one of the most sought after blue chips on the Bucharest Stock Exchange and is also listed on the London Metal Exchange. The company's plant, based in southern Romania, has 3,650 staff and an output of 174,000 tonnes including primary aluminium ingots, bars, slabs, wire and alloys. The company exports more than 72 per cent of its production and accounts for 3 per cent of all Romanian exports. The EU countries, central Europe and the Middle East are the main markets. Alro was set up in 1965 and since 1997 it has invested tens of millions of dollars in upgrading its basic facilities and purchasing new equipment. The modernisation of technologies was achieved using Alro's own financial resources and with technical assistance from prestigious foreign firms such as Aluminium Pechiney (France), Bertin (France), BHA (Germany), and Continuous Propertzi (Italy). Following this upgrading process, the company achieved a gross profit of over US\$ 58.2 million in 2000. An important aspect of the modernisation was to improve environmental standards. Alro has announced plans to invest US\$ 100 million over the next three years to finalise the upgrading works. In October 2000, the government offered for sale its 54.72 per cent stake in Alro jointly with a 70 per cent stake in Alprom SA, a smaller and less profitable aluminium product manufacturer. A number of the world's leading aluminium producers initially showed an interest in placing bids for the companies, including Alcoa Inc. (US), Alcan Aluminium Ltd. (Canada), and Pechiney SA (France). However, the previous government did not provide a final submission date for the potential bidders to present their bids for the companies and so the privatisation process was put on hold as the general election approached. The new government has yet to re-launch the privatisation process and a governmental decision on the pace and timing of the privatisation is now overdue.

In the second part of 2000, the government initiated the privatisation process for five large metallurgy companies:

- SIDEX, Romania's largest iron-and-steel combine based in Galati (see box);
- Alro, the largest aluminium producer, jointly with Alprom, a smaller producer (see box);
- Siderurgica steel combinat located in Hunedoara;
- COS steel producer in Targoviste; and
- ISCT in Campia Turzii.

Sidex

Sidex, Romania's largest steel company, is being prepared for privatisation. Sidex is the giant of the industry that alone accounts for around 63 per cent of the sector's output. The company is a fully integrated steel plant producing mainly flat steel. It is based in the Danube port of Galati, an excellent location, as it offers dedicated harbour and direct water links with the Black Sea port of Constanta as well as central and western Europe. The company is highly export oriented; it has export contracts with almost 40 companies. Among the export markets, the EU countries, the Middle East, East Asia, especially Korea, and the CIS are the largest.

The ambitious eight-year modernisation and restructuring plan adopted in 1994 brought positive results and helped Sidex to re-orient itself towards downstream, higher value added products.

In the first nine months of 2000, despite a slight drop in production levels, Sidex made a small profit.

The former government launched the privatisation of the company in December 2000 through APAPS (formerly the SOF) with a bid submission date of 5 April 2001. Despite strong initial investor interest from companies such as Usinor (France) and Marcegaglia (Italy), only Ispat (Netherlands) appears to have placed a bid bond to APAPS ahead of the initial bid submission date.

Automotive industry

The automotive industry is a sector with very high foreign penetration. Two large foreign car makers, Daewoo and Renault, have producing facilities in the country, and numerous parts production plants were opened in recent years.

Dacia, the largest passenger car producer, was privatised recently and is preparing for a major leap forward with the help of investments from its new owner, Renault. The French car maker paid US\$ 50 million for a 51 per cent stake in Dacia and pledged US\$ 260 million for an investment plan for the coming five years. In 2000, Renault started the reorganisation and modernisation of Dacia's management and production facilities. Renault's overall investment programme envisages an annual output of 200,000 cars by the year 2010, of which 80,000 will be export-bound. Among the plans is the development of a new low-budget model, priced below US\$ 6,000, by 2003, which is to be sold on emerging markets in the region. The company's operations are being strongly supported by a number of incentives that were agreed between Renault and the government at the time of the sell-off. Among them are a five-year exemption from profit tax, customs duties and VAT on imported inputs and technology, and a three-year lag in VAT payment on cars sold in Romania.

Another major foreign investor in the industry is Korea's Daewoo. The company's Romanian subsidiary, Daewoo Automobile Romania, produces around 30,000 cars annually, which are largely sold in the domestic market and in other eastern European countries. Daewoo has achieved a very high level of integration to the Romanian car parts industry, as 58 per cent of the spare parts used are domestically produced. The company co-operates with 226 Romanian

Recent major investments in the car parts industry

Company	Investor's country of origin	Investment, US\$m	Activities	Location
Continental	Germany	52, plus 35 planned	Tyre making, target 8m tyres pa for regional distribution	Greenfield plant in Timisoara, opened October 2000
Autoliv Romania	Sweden	na	Automotive safety systems, e.g. safety belts and airbags, for Dacia and Daewoo Romania, air bags for BMW	Plant outside Brasov, plans to build 11 new units
Phoenix Automotive	UK	120	Plan to produce rubber car parts	Carei Satu Mare
Lisa Draxlmaier	Germany	50	Cable and wiring for vehicles	Main plant in Timisoara plus 3 other facilities
Alcatel Romania	France	na	Car cable production for BMW, VW and Audi	New factory opened summer 2000, Arad county
ThyssenKrupp	Germany	27		Two JVs in Sibiu creating 1,000 jobs

Source: Reuters

producers who supply more than 1,000 high-quality parts. The total value of the products bought from the Romanian horizontal industry in first six months of 2000 was more than US\$ 2.7 million. Through the contracts concluded with Romanian producers, Daewoo ensures 15,000 jobs for them. The integration of Daewoo production is 58.21 per cent. In February 2001 the management of Daewoo Automobile Romania issued a statement saying that the difficult situation of other companies where Daewoo Motor Co. is a shareholder does not affect the activity of Daewoo Automobile Romania.

Car parts industry

The Romanian car parts industry initiated rapid expansion over the last two years as several large foreign car parts producers established production plants in the country. Analysts believe that Romania has the potential to copy the success of other central European countries, e.g. Hungary, Slovakia or the Czech Republic, which have established a booming car parts sector supplying large car manufacturers with assembly plants in the region or in western Europe.

Telecommunications

The Romanian telecommunications sector is relatively underdeveloped even by regional standards. Line density has been 17.5 per cent by end 2000, as compared to 33.6 per cent in neighbouring Bulgaria. However, in recent years the modernisation of the sector has started with the privatisation of the national fixed-line company, RomTelecom, the launch of several infrastructure investments, and the rapid growth of the mobile telephone market. The government also intends to proceed with legal and institutional reform, and with the privatisation of SNR, the national broadcasting company, and the further privatisation of RomTelecom in 2001.

The country's fixed line monopoly, RomTelecom, underwent successful privatisation in 1998, when OTE, the main Greek telephony operator, purchased a 35 per cent stake. From 1999, the company started to make large investments into modernisation, network expansion and the improvement of the efficiency and quality of its services. RomTelecom is a highly prosperous company. The 1999 figures were above all expectations, as it registered a profit of US\$ 82 million and current estimates for 2000, based on the statutory Romanian accounts, are for profits of approximately US\$ 70 million. Fixed telephony brings in 80 per cent of RomTelecom's revenues. The company has several subsidiaries that operate in mobile telephony, the Internet and cable television networks.

Starting from 1999, RomTelecom launched large-scale operations to modernise its infrastructure. The company earmarked US\$ 2.36 billion for investments over the next four years and pledged to increase telephone density to 23 per cent by 2003. In 1999, 520,000 digital telephone lines were installed, of which 350,000 were new, and the rest replaced old lines. During 2000, RomTelecom successfully installed 420,000 new telephone lines thus completing the digitalisation of 55 per cent of the whole network. One of the company's priorities is to connect isolated and economically underprivileged towns into the network. RomTelecom has contracted Alcatel (France), Siemens (Germany) and Ericsson (Sweden) for these infrastructure projects. Alcatel is to supply around 650,000 lines over the next five years, while Ericsson is providing its latest AXE switching solutions, modernising the network and bringing it closer to the desired level of digitalisation.

The Romanian government intends to launch SNR, the national radio-communications operator, for privatisation. The company provides broadcasting and data transmission services. In view of the sectoral deregulation planned to take place in 2003, SNR's strategy is centred on the transformation of the company from a broadcasting business into a multi-functional telecommunications company.

Mobile telephony

Romania's mobile telephony market has been experiencing strong growth in subscriber numbers and system usage in the last few years. Currently, there are two large GSM operators, MobiFon-Connex and MobilRom, and two small, CosmoRom and Telemobil. MobiFon-Connex, which has around 1 million customers, is majority owned by Canada's Telesystem International Wireless and AirTouch Communications, recently purchased by UK's Vodafone. MobilRom is run by a consortium headed by France Telecom and also claims around 1 million subscribers. A third company, Telemobil, operates on the 450 MHz band in a few cities but its network only covers a small territory of the country. In May 2000, RomTelecom launched its own mobile telephone operator, CosmoRom, making the market even more competitive. OTE plans to invest US\$ 700 million in mobile telephony over the coming years.

The authorities are planning to offer three licences for operating UMTS (Universal Mobile Telephony System) network in the year 2001. Licences can be issued to existing operators in the Romanian GSM telephony market that already have a customer network, but also to new operators, which may stimulate competition, according to the authorities.

The EBRD has actively provided assistance for the Romanian telecom sector since the early 1990s. In the EBRD's view, developing the telecom network is a vital condition for attracting more foreign companies to do business in Romania. The EBRD provided RomTelecom with an ECU 142 million sovereign-guaranteed loan in 1992 and a further US\$ 100 million loan in 1998 aimed to help the company's restructuring before privatisation. In 1997, the EBRD arranged a US\$ 190 million financing with GSM operator, Mobifon. The EBRD has also invested in a joint venture, EMCOM S.R.L., formed by Siemens (Germany), Electromagnetica (Romania) and RomTelecom, to manufacture telecom equipment.

Oil and gas

Romania has considerable oil and gas reserves and also a large scale and highly developed refining industry. Currently, the two state-owned national companies, gas firm Romgaz and oil company SNP Petrom dominate the industry. An influx of western investment and technology has started in the last few years as several foreign firms received concessions for oil and gas exploration. In addition, the privatisation of refinery facilities has advanced and the oil retail sector is becoming highly competitive with the recent entry of large foreign fuel distributors.

The restructuring of the gas and petroleum industry has been under way since the early 1990s, with the following aims:

- to increase/maintain the volume of domestic oil and gas production;
- to modernise production facilities with special emphasis on environmental protection;
- to improve the operational and financial efficiency of SNP Petrom and Romgaz;
- to establish a suitable regulatory framework; and
- to promote private sector investment in the petroleum sector.

Several international donors such as the EBRD, EU-PHARE and the World Bank have assisted these efforts. In 1992, the EBRD provided an ECU 22 million loan to Petrom, which was used to upgrade production equipment at three production sites and improve research facilities, and establish a computerised commercial accounting system at the former oil production company Petrom RA.

Gas

Romania has considerable reserves of natural gas with potential for another 25 years. Current gas production totals about 14 billion cubic metres, of which about 7-8 billion are extracted by Exprogaz (a unit of Romgaz) and almost 6 billion by the national oil company SNP Petrom.

The restructuring of Romgaz was finalised in the summer of 2000. The company was reorganised into five independent units: Distrigaz Nord and Distrigaz Sud are two companies that purchase and distribute gas. Transgaz took over the transport services. Exprogaz's activities are production, exploitation and storage of natural gas and geological research for finding hydrocarbon resources. Depogaz is responsible for underground storage of natural gas. According to the authorities, the new structure is aligned to European standards in a legal sense.

The restructuring aims at the de-monopolisation and the introduction of competition to the sector. On the supply side, the two important suppliers, Exprogaz and SNP Petrom, jointly cover 70 per cent of domestic gas requirements. The rest is covered by imports, which come from various trading companies. On the distribution and sale side, apart from Distrigaz Sud and Distrigaz Nord, there are 30 large customers connected directly to the gas transport network, who are thus direct buyers. Some private involvement in the gas distribution and marketing sector has started through joint venture arrangements such as the one between Wintersall and former Romgaz or between Enron (US) and SNP Petrom.

Oil

Romania extracts around 6 million tonnes of oil annually and its production is about to receive a major boost through the excavation of a recently discovered large-size oil deposit in the Black Sea that started in 1999.

SNP Petrom dominates the oil sector. It is one of the largest oil companies in the whole of the eastern Europe with share capital of US\$ 1 billion and a turnover of around US\$ 2.0 billion per year. It is responsible for distribution of around 40 per cent of the Romanian oil market. The company is vertically integrated, and its four main divisions cover the following activities:

- Exploration and extraction. It operates one off-shore and 10 on-shore branches exploring and exploiting hydrocarbon reserves in the Black Sea.

- Refining and processing of crude oil and natural gas. It has two refineries, accounting for about 29 per cent of national refining capacity and some 30 per cent of the distribution of oil products market.
- Oil transport. It has two branches: Transpeco for road transport, and Petrotrans for rail distribution. The company has 157 warehouses and storage depots and over 600 petrol stations. The transport system also includes 2,500 kilometres of pipelines.

The government has been trying to privatise Petrom. A 35 per cent stake was offered for sale in 1999, but the bids submitted were found unsatisfactory. The new government is preparing a new privatisation strategy.

Petrom is one of the most dynamic and prosperous Romanian companies. In 1999, it recorded US\$ 33 million in profit and US\$ 1.8 billion in turnover. The company's good performance continued in 2000, when profits of US\$ 100.1 million were reported. The company is involved in world markets through extraction activities abroad and export of refinery products. It exports around 35 per cent of its production each year and has exploitation agreements with India, Nigeria and countries of the Arabian Gulf. Recently, Petrom invested US\$ 3-4 million to start up exploration works in Kazakhstan, where it has leased oil fields. It paid US\$ 2.75 million for the necessary licences and authorisation and for site construction. Activities started in late 2000.

Upstream activities

In recent years, foreign companies have increasingly participated in oil exploration in Romania. A major discovery of crude oil under the Black Sea, announced in early 1999, attracted the interest of foreign drilling companies. In 1999, French oil company Elf Aquitaine formed a joint venture with Petrom for oil exploration and drilling in the offshore Neptun oil block. The joint venture is exploring an area of 6,400 square kilometres, believed to hold the largest deposit uncovered in the last 25 years. Romania has not previously explored the Black Sea, for lack of the necessary equipment.

In summer 2000, Sterling Resources Ltd., a Canadian oil company, obtained a licence for exploration and drilling in the Craiova area, southern Romania, and is exploring a 600,000-hectare area for both oil and gas. Other big oil giants, Shell

(UK-Netherlands) and BP Amoco (UK) spent more than US\$ 100 million in 1992-97 to identify oil reserves in western Romania.

Downstream activities

With the largest refining industry in central and eastern Europe, Romania produces a wide range of oil products and chemicals. The sector is undergoing a long-term restructuring process which started in 1992 and involves some capacity reduction and a move towards specialisation in high-demand products such as lubricants, bitumen and fertilisers. With its two large scale and one small refineries, Petrom accounts for 29 per cent of all refining capacity.

In an important development, the refinery sector started to attract foreign investors in the late 1990s. One major deal was Lukoil Europe's (Russia) acquisition of 51 per cent of Petrotel, the third largest refinery in Romania. Lukoil has been investing into the modernisation of the refinery and is also supplying 3 million tonnes of crude oil per year. In November 2000 the largest oil refinery, Petromedia, was privatised to Rompetrol Group, a Romanian-owned Dutch company, which also holds a majority stake in another small Romanian refinery, Vega.

Pipelines

Italian oil company ENI, in co-operation with Petrom, has been developing plans to build a pipeline for the transport of Caspian and Black Sea oil to western Europe. The plan envisages Caspian crude oil being carried across the Black Sea from the Russian port of Novorossiysk and Supsa, in Georgia, to depots in Constanta, and then through a pipeline across Romania, FR Yugoslavia, Croatia and Slovenia to Trieste, in Italy. An important part of the project is the extension and modernisation of the oil terminal at Constanta. The company running the terminal is to invest US\$ 75 million to upgrade infrastructure in preparation for the pipeline project. The investments would be for the extension of storage facilities, an anti-pollution project and purchases of state-of-the-art safety and measurement devices. Ruhrgas (Germany) is another foreign strategic investor that is planning a major pipeline project in Romania. In September 2000, the German company announced plans to build a US\$ 50 million gas pipeline to connect the Romanian and Hungarian gas networks.

Fuel distribution and retail

There has been a recent explosion of foreign investment in the Romanian oil retail market as large foreign fuel distribution companies, such as Shell (UK-Netherlands), Agip (Italy), MOL (Hungary), Lukoil (Russia) and OMV (Austria) have moved in and started expanding. At present, foreign companies hold 18-20 per cent of the market, but this share is expected to double in the next two years, further eroding the dominance of Petrom, which runs 600 petrol stations all over the country. The success of foreign retailers is largely based on aggressive marketing strategies involving advertising and promotional prices.

In July 2000, Shell, the largest foreign player, announced a plan to invest US\$ 10 million to expand its petrol stations network. Shell already has 72 stations and has invested some US\$ 155 million in oil exploration, extraction and retail. Agip, which entered the Romanian market in 1995, has limited its development to a distribution network of 15 petrol stations located in the southern region. In two years since it entered the Romanian market Lukoil has built 10 stations, but it plans to extend this network to 40-50 petrol stations in the next two years. The most recent company to announce plans to invest in Romania is OMV (Austria), which has branches in several central European countries. OMV aims to win 10 per cent of the market with 100-120 stations over the next four years. It plans to concentrate its network in Transylvania and in the southern regions through direct investments and by taking over petrol stations from independent oil retailers.

Under the pressure of increasing competition in its home market, Petrom has announced plans to launch a major upgrading of its Romanian network (some 100 stations have been modernised over the last three years) and has also started expansion into neighbouring countries. In August 2000, in Chisinau, Moldova, the company inaugurated its first station, which is intended to be the first unit of a nationwide chain. In summer 2000, Petrom also announced plans to invest US\$ 10 million in Hungary over the next few years to construct a network of six petrol stations (two of which have already opened) and a fuel storage facility.

Fibrex debt financing

Fibrex is a Romanian nylon producer that was bought in January 2000 by RadiciNylon, a subsidiary of the Radici Group of Italy. The Group has an annual turnover of around € 1.4 billion, while RadiciNylon is Europe's third largest nylon producer with a turnover of around € 300 million in 1999.

The Radici Group has started an important modernisation and investment programme in Fibrex. In addition to its own financing, RadiciNylon will receive a € 10 million loan from the EBRD to support the development process. The priority is to return Fibrex to profitability through increased productivity, product quality and sales. RadiciNylon is introducing Fibrex's products to new export markets in western Europe.

The demonstration effect of a major restructuring effort by a foreign investor in a difficult industry, such as the chemical sector, will benefit Romania. The availability and improvement of Fibrex's products will also benefit the local textile and automotive sectors.

Energy

The energy sector restructuring process has been progressing well over the last few years. The programme is concentrating on demonopolisation and opening up the market to competition as a first step. Regulations for granting licences to power-generating and distribution companies were approved in July 1999. An independent sector regulator agency (ANRE) was established and 15 companies were given supply licences in the first half of 2000.

In February 2000, Romania opened up 10 per cent of its energy market by allowing 10 large industrial companies to choose their own electricity supplier and granting electricity supply licences to five local independent producers. In October 2000, the government decided to increase the degree of liberalisation to 15 per cent. This move opened the way for new companies to apply for permits to choose their own supplier. The competition between electric power producers is expected to lead to price decreases.

As a major step in the restructuring process, in July 2000 **Conel**, the national electricity company, was split into four independent units to handle electricity transport, production and distribution. The move was intended to eliminate the

state's monopoly in the sector and pave the way for sell off.

The successor companies are as follows:

- Transelectrica, responsible for electricity transport across Romania and ensures the country's national power grid links to its neighbours. Transelectrica is also the sole shareholder in a separate company named Opcom, responsible for the local energy market and electricity transport through eight branches across Romania.
- Termoelectrica, responsible for production and supply of electricity and thermal power. Termoelectrica's output is produced by coal and hydrocarbon power plants. It ensures 40 per cent of Romania's thermal power needs.
- Hidroelectrica, responsible for electricity production using hydroelectric power.
- Electrica, responsible for electricity distribution.
- Nuclearelectrica, responsible for operating the Cernovoda nuclear plant.

Conel's successor companies supply about 8.2 million customers and account for 96.7 per cent of electricity produced in Romania. Each of these companies is state owned, with the state represented by the Ministry of Industry and Trade. The government is preparing strategies for the sale of some of Conel's successors, in particular in the electricity distribution sector.

Transelectrica plans to become a large regional electricity exporter targeting neighbouring countries. Since current electricity production is about twice domestic consumption, and many neighbouring countries are electricity importers, this plan holds potential. Possible buyers include Greece, Turkey and Italy. In order to fulfil these plans, the company is preparing a project to integrate with the electricity grid of the western European countries. The project will cost US\$ 823 million and will be implemented by the year 2003.

Several foreign engineering and energy firms have participated in upgrading plants at various locations. One example is Fortum Engineering (Finland), which is involved in four major projects for the upgrading and rehabilitation of the thermo-electric power stations belonging to Termoelectrica. Another company active in this field is Asea Brown Boveri (Germany), which has formed Electro-Invest, a joint venture for developing a district heating

facility. Finally, in June 2000, Cogen Consortium/NCC (Holland) set up a joint venture with the municipalities of Cluj and Targoviste to upgrade and operate two power plants. Investment in the project, which also aims to cut greenhouse gas emissions at the plants to EU stipulated levels, has been estimated at US\$ 95.7 million.

Transport

Romania has been running several major programmes to upgrade the rail and road networks. Many of these projects are being implemented with the assistance of international institutions (the EBRD, the EIB, the World Bank, JBIC and the EU's PHARE and ISPA), and international private capital is also being sought. The country's largest port, Constanta, which is undergoing modernisation, and the possible privatisation of TAROM, the national air transport company, also offer opportunities for foreign investors to enter this sector. The EU's latest progress report on Romania praised the country for making significant progress with the adoption and implementation of the transport acquis in the last few years. Further work is requested especially in the fields of road haulage transport (fiscal harmonisation, technical requirements and safety legislation) and maritime safety.

EU-ISPA Programme

Romania is the recipient of funding from the EU-ISPA Programme that provides support for the transport and environment sectors, with an annual allocation of EUR 208-270 million for the period 2000-06.

In the field of environment the ISPA strategy concentrates on "heavy investment" directives (mainly drinking water and treatment of waste water, but also solid-waste management and air pollution) that are intended to bring Romania up to EC standards. In 2000, several investment projects focusing on waste-water management started to receive funding.

In the field of transport, the upgrading of transport Corridors IV and IX (for both road and rail) are the priorities. Three projects have been approved for ISPA assistance in 2000: widening the Bucharest-Giurgiu road to four lanes; construction of the Bucharest-Cernavoda motorway; and upgrading of the Bucharest-Constanta railway line.

Air transport

The air market in Romania has been steadily expanding with annual air traffic growth of 20 per cent. The government intended to launch TAROM, the national air transport company, for privatisation in 2000. However, the privatisation of TAROM has been postponed until late 2001 on the advice of the government's privatisation advisers, ABN Amro. The company is incurring some losses and prospects for a strategic sale are low.

The rise in air travel has delivered some benefits for TAROM, which performed well in 1999 and beginning of 2000. During the first five months of 2000, the number of passengers using TAROM international flights went up by 25 per cent compared with the same period in 1999. The company's management started a restructuring programme in 1997, which included staff reduction, purchases of new aircraft and the introduction of new destinations. Bucharest's main international airport, Otopeni, has received a major facelift and now offers services on a par with west European airports.

New private airlines

In the last few years, several smaller private domestic companies have entered and established a firm place for themselves on the commercial aviation market. These companies operate in sub-sectors where they can avoid competition with TAROM, such as regional transportation or tourist charter flights. The three most important companies are: Airom 2000, which runs tourism charter flights mostly to the eastern Mediterranean; Carpatair, which covers regional transportation and operates with small aeroplanes with an average of 20 passengers; and Acvila Air, which specialises in armament transportation and also runs regular passenger flights to Ukrainian cities in collaboration with Air Ukraine.

Railways

Railway transport has undergone the most changes of all public utilities in Romania. The first step in the restructuring of SNCFR, the Romanian National Railway Company, which started in 1998, was the division of the company into five independent entities: CFR Passengers, CFR Freight, CFR Infrastructure, the Railway Financial Management Company and the Railway Assets Administration Company. With this move, Romania became the second country in Europe, after

the UK, where transport operators are separated from the railway infrastructure. In February 2000, in the next stage of reorganisation, CFR Passengers was divided into eight regional units; however the new government is reconsidering this measure. The authorities have declared that privatisation, in particular of CFR freight, will be the final stage of the railway reform.

SNCFR's restructuring programme has started to show positive results, as all the successor companies showed increasingly positive financial performance in 1999 and 2000. They managed to clear much of their debts to the state budget and also increased the salaries of their employees. In the medium term, these companies are supposed to reduce their state subsidy requirements from the current 70 per cent to 50 per cent.

In parallel with the re-organisation of SNCFR, a major rehabilitation and modernisation of railway infrastructure has been going on. Financial support for this programme, with an overall cost of US\$ 420 million, is being provided by international agencies including the World Bank, the EBRD, the EIB, and EU-PHARE. The EBRD assisted with a US\$ 72.6 million loan in 1996, which was used to help re-organise SNCFR along commercial lines, provide staff training and upgrade lines, locomotives, wagons and the telecommunications network.

Roads

Romania has been pursuing a strategic plan for the development of its road network with three priorities:

- rehabilitation of the main international routes;
- modernisation of the existing national road network; and
- motorway construction, with priority given to east-west connections (Bucharest-Pitesti and Bucharest-Constanta).

The EBRD has contributed to the road network upgrading programme in two ways. Firstly, by helping with the institutional restructuring and commercialisation of NAR, the National Administration of Roads. NAR is a state-owned, but autonomous entity funded by the state budget and other revenue sources. It is responsible for the administration and management of the national roads and bridge network. Secondly, the EBRD has contributed to several road rehabilitation projects, including the upgrading of the Bucharest-

Pitești highway, which was opened in autumn 2000 and supported with a US\$ 53.1 million loan. The total cost of the project is US\$ 103.4 million, of which the EBRD is financing 51 per cent and NAR is contributing the rest. The EIB is supporting another major motorway construction with a US\$ 212 million loan to finance the completion of a motorway connecting Bucharest with the port of Constanta, part of Pan-European Transport Corridor IV. Another road building project to be financed under the umbrella of the Stability Pact is the construction of a 48-kilometre section of Corridor IX (running north-south from Helsinki via Russia and finishing on the Greek coast) between Bucharest and Giurgiu at a total cost of € 66 million, to be financed by the EC (US\$ 43 million) and the Romanian government (US\$ 23 million).

Shipping

Constanta, the biggest Black Sea port, is Romania's major seaport. The port has great natural advantages and for centuries has been a valuable trade link between Europe and Asia. The authorities and the port management are actively seeking ways to plan and finance the development of the facilities. The EBRD has provided technical co-operation to develop a programme to attract private sector financing for the port's operations. Further support came from the EIB in 2000 in the form of a € 15 million loan to Constanta Port Administration (MPAC) for a number of investments intended to improve the environmental situation in the port area and waters and to ensure adequate power supply to commercial companies operating in the port.

The port has already undergone some reorganisation to increase its flexibility and financial standing. In October 1998, the Constanta Port Administration was converted into a joint-stock company, Maritime Ports Administration Constanta (APMC), under the authority of the Ministry of Transport. APMC is now authorised to increase its capital and to sell shares, to issue bonds and to set up joint ventures both with Romanian and foreign companies. The change in the company's legal status has also laid the groundwork for privatisation.

Constanta can receive vessels up to "Suez-maximum" size and its terminals allow the handling of almost all kinds of cargo, with an annual capacity of 85 million tonnes. The port has been experiencing positive growth due to the recent rise in

Romania's exports. Maritime freight traffic increased by 4.6 per cent in the first nine months of 2000, compared with the same period in 1999.

The port administration has started promoting Constanta Port on prospective markets by opening in October 2000 an office in Budapest, the task of which is to provide information on the facilities offered by the port and to establish contacts in order to increase the traffic of commodities from central and western Europe. Constanta also has good chances of becoming a major transit route for the shipment of Caspian oil towards Europe.

The Danube, which flows for 1,705 kilometres along Romania's southern border, also provides the country with a principal trade connection. The river was blocked by fallen bridges as a result of bombing during the Kosovo war, but the route will be re-opened with international help in 2001.

Tourism

Romania offers an enormous variety of natural and historic sights for the visitors. The most attractive regions are:

- the Carpathian mountains, ideal for winter sports and trekking;
- the Transylvanian region, rich in mediaeval towns and castles, and spa resorts;
- the Danube delta, an attractive place for fishing and birdwatching;
- northern Moldavia, home of spectacular Orthodox monasteries; and
- the Black Sea coastline, offering excellent beaches.

Romania has made a strong effort in recent years to improve its tourism infrastructure. It has set up a 18-strong network of tourist promotion offices abroad and has spent large amounts on advertising and PR campaigns. The results started to show in 2000, as recent data indicate that the number of foreign visitors in the first half of 2000 increased by 7.4 per cent to 2.36 million compared with the same period in 1999, with large number of visitors coming from west European countries.

Large-scale privatisation of the tourism industry is an ongoing process. The Ministry of Tourism (MT) aims to attract some strong foreign investors for the upcoming privatisation. As many as 224 tourism companies have been privatised in

the last decade out of a total of 283. MT plans to coordinate the sale of 51 companies by the end of 2001. Through an investment in the Romanian Post Privatisation Fund, the EBRD has indirectly made an investment in the Continental Hotel chain of hotels operating across Romania.

Industry specialists agree that growth in the Romanian market is strong enough to support a large number of new hotel facilities, especially in the luxury and middle level categories. Some of the leading international hotel chains have already been active in the country since the mid-1990s, but the recent growth in the sector has prompted a second wave of investment. One example is the construction of a large business hotel in the rapidly developing port of Constanta and the rehabilitation of Bucharest's former Nord Hotel, both done by the Accor Group (France). In 2000, there were also two new additions to Bucharest's top hotels, the Marriott Grand Hotel and the new Holiday Inn (located next to Bucharest's international airport). Previous investors in this segment of the market include the Hilton group (US), which has a 20-year management agreement to operate one of Bucharest's leading hotel, the Athenée Palace.

EBRD loan to benefit tourism and environment

Romania's main tourist destination, the Black sea coast, will benefit from an extensive upgrade to its waste-water infrastructure through financing from the EBRD. In November 2000, Constanta Water Company, the local service utility, received a € 20 million corporate loan from the EBRD as part of an overall environmental improvement programme totalling around € 100 million. A further € 72.4 million is earmarked to come from EU ISPA grants. The funds will finance the refurbishment and modernisation of waste-water pumping stations, sewerage systems and overflow structures. The EBRD loan is also to help the conversion of the Constanta Water Company into a joint stock company and help in the search for a private sector partner for further investments.

The Romanian Office for Tourism has launched Romania's official tourism site, accessible on-line at **www.romaniatravel.com**.

Victoria Center Office Building

Victoria Center Office Building is EBRD's first private sector office building development project in Romania. It is a flagship project in terms of the local market and one of the largest in recent years for the Romanian office building industry. The project consists of the financing of the development, construction and management of a 17,000 square metre class A office building, located off one of Bucharest principal squares housing the office of the government, and on one of the city's main boulevards and thoroughfares. The project sponsor is Nobelgo, established in 1994 as the investment vehicle of Kardan Group for international real estate projects. Kardan Group is a diversified Israeli holding company listed on the Tel Aviv Stock Exchange. Kardan Group is providing the initial US\$ 6.5 million equity for the project development. The project cost totals nearly US\$ 22 million, most of which is for construction. The EBRD is providing total financing of US\$ 18 million, comprising a US\$ 7.6 million loan for the bank's own account and a loan of US\$ 10.4 million syndicated to Raiffeisen Zentralbank (Austria).

Agriculture and food industry

Romania has a strong agricultural tradition, and served as a major food supplier of eastern and central Europe in the nineteenth and early twentieth century. In the early 1990s, transition hit the sector hard, but since then there has been some progress towards the sound development of agriculture. Production is dominated by cereal, sunflowers, vegetables, sugar beet, potatoes and fruits. Livestock consists mainly of cattle, pigs, poultry and sheep.

The current importance of agriculture is reflected in the high percentage of the labour force employed in the sector and the

high contribution to GDP. Agriculture accounted for less than 11 per cent of GDP in 2000, as opposed to 22 per cent in 1990 (at current prices). Employment in agriculture represented 41 per cent of the national labour force in 2000. In 2000, a further drop in output was expected in the wake of a severe drought that hit the sector in summer 2000.

Arable land privatisation has progressed quickly and around 85 per cent of land is now held in private ownership. A large number of these farms are small, with an average size of 2 hectares. The remaining arable land is under the control of 500 state farms. In autumn 2000, the government announced a plan to privatise around 150 of the state-run-farms by the end of 2001. A major challenge is the establishment of an effective land registration system, which would greatly help the development of a land credit system and a secondary market for land that would facilitate farm restructuring.

Agricultural reform has been accelerated in recent years. Measures were taken to overhaul pricing policies and to dismantle subsidies, and for the creation of a functioning land market. At the same time, the domestic budgetary support for agriculture decreased in real terms from about € 500 million in 1999 to about € 330 million in 2000. The most important programme being financed by the state is social aid for small owners, which accounts for 60 per cent of total assistance. Outstanding problems are to facilitate the transformation of small-scale farms into viable holdings and encourage investment into the sector through the stabilisation of legislation governing land ownership, sale and leasing. In November 2000, the government announced the launch of a new programme to assist agricultural producers in purchasing farm equipment. The programme is likely to help small-scale agricultural entrepreneurs who lack capital to invest into modernising their farm production methods.

Starting from 2001, Romania will receive grants from the EU-SAPARD Programme, the pre-accession fund for agriculture and rural development. Annual funding will amount to € 153 million

during the period 2000-06. The Romanian SAPARD plan identifies four main priorities for intervention: improving the competitiveness of food processing; rural infrastructure; development and diversification of the rural economy; and development of human resources.

Food industry

The food industry accounts for about 18 per cent of total industrial output and 9 per cent of all industrial employment. FDI in the industry has been increasing in the last few years. The brewing and soda drinks sub-sector has attracted the highest amount of FDI. BBAG (Austria), South African Breweries, Netherlands Breweries Ltd. and Anadolu Endustri Holding (Turkey) are the major investors in Romania, which has the second largest beer market in central and eastern Europe after Poland. Another successful sector is wine production, with exports of wine representing one quarter of all Romanian agricultural exports to the EU. In other sectors, including meat and fisheries, canned fruit and vegetable processing and the dairy industry, the majority of enterprises remain state property. The EBRD has invested in the food industry alongside some major international companies. It took a € 7.2 million equity participation with Danone (France) in dairy product manufacturing facilities in Romania and also provided a € 5.2 million debt facility to Parmalat of Italy for the development of a dairy product and juice manufacturing plant serving the Romanian market.

There is also a growing interest by foreign investors in the tobacco sector. Multinational companies present are RJ Reynolds (US), Philip Morris (US) and British American Tobacco. In 2000, the privatisation of Tutunul Romanesc, the National Romanian Tobacco Company (SNTR), was tentatively concluded, but then the decision was reversed by the government. The privatisation will be re-launched in the near future.



Financial sector

In 2000, Romania took important steps to improve its financial system including speeding up bank bankruptcy procedures, privatisation, and improving the management and supervision of both the bank and non-bank financial sectors. The privatisation of large state banks has been progressing with Banca Agricola, the agriculture bank, and the largest state bank, the Romanian Commercial Bank, scheduled for privatisation in 2001. Meanwhile, large foreign insurers have been entering the Romanian market, which is expected to deliver high growth in the coming years.

Banking sector

In 2000, the National Bank of Romania (NBR, the central bank) worked to improve the implementation of the legislative framework for the banking sector. Its supervisory capacities have been strengthened, with multilateral lenders providing assistance in establishing satisfactory safeguards. Problem banks will be more closely monitored, and guidelines for auditing, internal control and risk management have been established in line with internationally recognised practice.

The central bank has also established an early warning system. Banks are assessed and ranked on a scale of 1 to 5, banks that rate 1 being the best performers. The system, which was outlined as part of the IMF agreement, establishes the regulations for troubled banks and specifies the point at which a bank's licence will be revoked and liquidation proceedings started. Other positive developments include the establishment of a credit information centre at the NBR, which will allow banks to obtain information on the credit history of borrowers.

The government took important measures to regulate mutual financial intermediaries (MFI), following the collapse of the National Investment Fund (FNI) in May 2000, the largest investment fund in Romania. The collapse of FNI put pressure on the largely unregulated "popular banks" that are credit co-operatives without deposit insurance. The NBR's authority has been broadened to include the authorisation, regulation and supervision of credit co-operatives.

Total assets in the Romanian banking system currently amount to around US\$ 10 billion. The sector is relatively concentrated, with four majority state-owned banks accounting for 31.7 per cent of credit and 48.7 per cent of deposits at the end of 2000. Domestic private banks account for 3.1 per cent of total assets and foreign banks, which are primarily active in the corporate market, for 52.6 per cent, of which 8.1 per cent represents the share of foreign bank subsidiaries.

Bank restructuring

At the end of 1998, the Romanian authorities established an Asset Recovery Agency (AVAB) in order to manage the bad and doubtful loan portfolios of large state-owned banks. In December 2000 the Agency was restructured and became the Office for the Recovery of Bank Assets (ORCB), under the direct co-ordination of the General Secretariat of the Romanian government. The agency had to deal with the restructuring of a number of banks. Among them, the largest was Bancorex, the foreign trade bank monopoly prior to 1989. It was placed under NBR special administration in March 1999, with the viable part of the business subsequently absorbed by Banca Comerciala Romana. Bancorex accounted for two-thirds of all banking losses.

Next, **Banca Agricola (BA)**, the second largest state bank with a large exposure to loss-making enterprises in the agro-sector, was placed under special management in order to reduce losses and initiate the bank's restructuring. The bank was also subjected to a freeze on new lending in 1999. Some US\$ 300 million in bad assets have been transferred from BA to the AVAB and have been replaced with an equivalent amount of government bonds. On 8 February 2001 the Budget-Finance Commission of the Chamber of Deputies passed the Ordinance approving Banca Agricola's recapitalisation by issue of government securities worth around € 157 million, with a view to privatising the bank. The deadline for bid submissions has been extended to 21 March, and Raiffeisen Zentralbank Osterreich AG (Austria) has expressed interest in becoming the majority shareholder.

Tighter regulations have also led to the closure of several insolvent private banks. One example is Banca Internationala Religiilor, which was initially placed under a special settlement regime by the central bank in May 2000. The bank's licence was subsequently revoked, and bankruptcy procedures have been initiated. These events have improved the financial performance of the banking system and, together with improvements in regulation, resulted in a significant fall in non-performing loans, which, as a percentage of own capital, had dropped from 253.6 per cent at the end of 1998 to 4.8 per cent by 31 January 2001.

Romanian Commercial Bank

The Romanian Commercial Bank (BCR) is the country's largest bank and ranks eight in the chart of the 100 most important banks in central Europe prepared by London-based *The Banker* magazine. By the end of 1999, BCR reported capital of US\$ 487 million and assets worth US\$ 2,849 million. BCR is one of the most important lenders to majority state-owned Romanian manufacturing firms, and the primary bank for Romanian companies. About two-thirds of domestic industry uses BCR's services. Concerning retail activities, in November 2000 BCR counted 2.2 million customers, a 22 per cent increase from the previous year. The sale of BCR is expected to go ahead in 2001.

Romanian Development Bank

The Romanian Development Bank (BRD) is the second largest commercial bank in Romania with 185 branches across the country and over € 1 billion in assets. It was privatised in 1998, when Societe Generale (France) acquired 51 per cent of the bank. The privatisation was actively supported by the EBRD, which became a 5 per cent shareholder. In 2000, for the third time in a row, BRD was named the best bank in Romania by the London-based Euromoney Publications group. In 2000, BRD had an outstandingly successful year. The net profit registered by the bank in the first half-year increased by 59 per cent against the profit in January-June 1999. At the same time, the number of individual customers increased by 56 per cent, while the number of corporate customers rose by 11 per cent.

Foreign banks

The banking sector has registered a high level of foreign involvement. Well known western banks such as ABN-AMRO, ING Barings, Citibank, Societe Generale, Bank Austria Creditanstalt, Raiffeisen Bank, Volksbank and Banca di Roma have branches or subsidiaries in the capital and in other major cities. Most of these banks operate in the corporate sector, offering services to local companies, financial institutions and multinational corporations active in the country. Others, such as Bank Austria Creditanstalt, offer services for individuals as well.

Turkish and Greek banks also maintain a large presence in the Romanian banking sector. EFG Eurobank (Greece) acquired a stake in Banc Post in May 2000. Meanwhile, Piraeus Bank (Greece) has fully acquired Romania's Banca de Credit Pater from Budapest Bank (Hungary). The bank has been renamed Piraeus Bank Romania.

Privatisation

Two banks have been successfully privatised so far. The first was the Romanian Bank for Development (BRD), sold in late 1998, with France's Societe Generale taking 51 per cent. To date, 92.68 per cent of the BRD's share capital has been divested to the private sector, of which 4.99 per cent was purchased by the EBRD. In 1999 came the sale of the state savings bank Banc Post, in which General Electric Capital (US) and Banco Portugues de Investimento (Portugal) jointly bought a 45 per cent stake. The sale of Banc Post was largely facilitated by a US\$ 10 million pre-privatisation subordinated loan provided by the EBRD in July 1998. EFG Eurobank (Greece) has since acquired 19.25 per cent of the share capital of Banc Post held by General Electric Capital.

The privatisation of two large state-owned banks, Banca Agricola (BA) and the Romanian Commercial Bank (BCR) is in progress. The deadline for the sale of BA was extended again to the end of March 2001 (see above).

Non-bank financial institutions

Stock exchange

Trading on the Bucharest Stock Exchange (BSE) started in 1995. A year later, an over-the-counter market (RASDAQ) was launched, enabling citizens to trade shares acquired through the mass privatisation programme. There are two tiers of listed companies on the BSE. The first tier has more strict reporting and accounting requirements and currently consists of 27 companies. The main BSE index is the BET (Bucharest Exchange Trading). It is a capitalisation weighted index created to reflect the movement of the 10 biggest and most liquid stocks traded on the first tier.

Following the early years of boom, stock values were badly affected by the withdrawal of foreign capital after the turmoil on Asian and Russia financial markets in 1998. The BSE composite index fell by nearly 50 per cent and the RASDAQ composite index fell by 20 per cent. The BSE composite index recovered by 32 per cent in 1999 and the RASDAQ index by 7 per cent.

In 2000, the market was characterised by a severe lack of liquidity. The exchange had an average daily turnover of US\$ 200,000 compared with US\$ 3 million during the boom of 1997, and around 1,500 to 2,000 transactions per day. The BSE has been trying to attract investors through aggressive marketing and also by strengthening its regulatory environment.

It has ceased to deal with companies that fail to meet the regulations and in 1999-2000 29 such companies were delisted. Analysts believe that an acceleration of the country's privatisation programme would serve to reverse the decline of the BSE.

The Romanian National Securities Commission is the main regulatory and supervisory body for the securities market. The commission was established in October 1994 as an independent administrative authority, under the control of Parliament. In 2000 the Commission concentrated on strengthening its regulatory and supervisory capacity in order to meet the new developments in the market. In August 2000, the Commission became the regulatory and supervisory authority for the commodity exchanges.

Insurance

Despite economic hardship, the insurance market has been steadily expanding over the last few years, with an increasing number of major industry players developing their business in Romania. The market reached US\$ 150 million in 1995 and US\$ 270 million in 1999. A 15-20 per cent development is expected in 2001, with life insurance increasing the most. The market is presently under transition, as the current dominance of state-owned insurers is being rapidly eroded by foreign insurance companies. During 2000, through a regional participation with TBI Holdings, the EBRD undertook a € 4.1 million equity investment in Omnisig, a Romanian insurance company.

The most important actors are Asirom, Omnisig, Allianz-Tiriac and Astra insurance companies, which together hold around 65 per cent of the market. The biggest player in the non-life insurance market is Asirom, with revenues deriving mainly from motor and third-party liability as well as transport and property policies.

The largest foreign players already present in the market are CGU (UK), Nationale Nederlanden (Netherlands), the life-insurance market leader, Merkur (Austria), TBI Holding (Netherlands), Generali (Italy) and AIG (USA). The market witnessed several new entries in 2000. German giant Allianz AG bought a 51 per cent stake in Asigurari Ion Tiriac, which ranks number three in the sector. The UK's Commercial Union and Austria's Grawe also

launched local operations. Finally, in December 2000, Austrian-based Wiener Stadtische bought a 51 per cent stake in local insurance company Unita, thus becoming the third Austrian insurer to be active on the local market. Unita product sales are being conducted in cooperation with Bank Austria Creditanstalt.

In April 2000, the Romanian Parliament adopted a new insurance law that largely brought legislation in line with the *acquis*. Through the introduction of higher capital, a solvency margin and technical reserve requirements, the law will promote consolidation of the Romanian insurance industry. The law also establishes the new Insurance Supervision Commission, an autonomous and self-financed body.

EBRD assistance to the SME sector

One of the most difficult barriers to the development of a sound private sector in Romania is the low availability of long-term finance and risk capital to SMEs. The EBRD has several projects that target SMEs:

- Romanian Post-Privatisation Fund. This is an € 44 million venture capital fund, supported by € 10 million of technical assistance from EU PHARE, to provide new equity capital and management assistance to Romanian medium-sized private and privatised industrial enterprises. The Fund usually invests between US\$ 1 million and US\$ 5 million for a significant minority position.

In addition, the EBRD uses Romanian banks as financial intermediaries to provide loans to SMEs. Some examples:

- Banca Transilvania, a Cluj Napoca based private bank, signed a loan agreement with the EBRD in 1999 for US\$ 5 million which is used for lending to SMEs. The money is provided under the SME Finance Facility established jointly by the EBRD and the European Union. Contributions from the EU finance the provision of a performance fee and a technical co-operation package.
- Banca Comerciala Romana signed a loan of US\$ 20 million in January 2001 to support SME sector development in Romania.

The EBRD also has an equity participation in and has signed a bank-to-bank loan with the Romanian Development Bank owned by Groupe Societe Generale (France). The bank offers medium to long-term finance for investment projects principally in the private sector. The maximum loan size is US\$ 5 million and there is no minimum loan size.

EBRD activities in Romania



Romania is a founding member of the European Bank for Reconstruction and Development (EBRD) and ranks among the top three in terms of signed projects, together with Russia and Poland. As at 31 December 2000, the Bank had signed over 60 projects in Romania totalling a net cumulative business volume of € 1,643.8 million. This represents 10.06 per cent of EBRD signed commitments. The Romanian portfolio is made up of the following sectors: transport, telecommunications, finance, tourism, agribusiness, private corporations, municipal utilities and energy.

Overview of EBRD activities and key objectives

The EBRD's investment programme has been marked by a clear focus on large-scale private transactions and on public-private partnerships in infrastructure along the following lines:

- private sector investment: New projects in paper manufacturing, GSM-based cellular telephone services and banking were signed in 1999. These include post-privatisation financing of the upgrading of a paper mill, the largest bank privatisation to date (Société Générale Romanian Development Bank) and the first credit line (Banca Transilvania) for small and medium-sized enterprises (SMEs) under the EBRD-EU Horizontal Facility.
- public-private partnerships in infrastructure: The EBRD continued an innovative approach to infrastructure investment by pioneering the use of private finance for public infrastructure. For example, the Bank extended its first two loans to private operators of water supply (Suez-Lyonnaise Timisoara) and district heating (Dalkia Ploiesti) services. The Suez-Lyonnaise Timisoara project was the first purely private concession of water and waste-water services supported by the Bank.

Since December 1999, Romania has been included in the group of EU accession countries. The government is committed to further accelerating the transition process and structural reform and to maintaining macroeconomic stabilisation. Its programmes include the privatisation of national and municipal utilities, restructuring of large loss-making commercial enterprises in the industrial sector, agricultural reform, and strengthening of the financial sector. The EBRD's emphasis on new investment in private companies and privatisation is consistent with the objectives of the government and complements structural reform. The EBRD's pipeline of projects is concentrating on:

- large-scale privatisation and restructuring with strategic investors;
- private sector investment in either local private or joint-venture projects;
- SME financing, banking and non-banking financial sector; and
- national and municipal infrastructure privatisation and public-private partnerships.

Contact names

Olivier Descamps

Business Group Director for
Southern and Eastern Europe and the Caucasus
Tel: +44 20 7338 6198
Fax: +44 20 7338 7218
EBRD, One Exchange Square
London EC2A 2JN
United Kingdom

Salvatore Candido

Country Director
Tel: +40 1 202 71 00
Fax: +40 1 202 71 1
EBRD Bucharest Resident Office

Strada Orlando 8

Sector 1
Bucharest
Romania

Mariana Gheorghe

Senior Banker
Tel: +44 20 7338 7133
Fax: +44 20 7338 7218 or 6159
EBRD Banking Department
One Exchange Square
London EC2A 2JN
United Kingdom

Office of the Director for Ukraine, Romania, Moldova, Georgia and Armenia

Yuri Poluneev, Director

Ionut Costea, Alternate Director

Yaroslav Issakov, Director's Assistant

Luda Paynes, Office Manager

Tel: +44 20 7338 6418
Fax: +44 20 7338 6055
One Exchange Square
London EC2A 2JN
United Kingdom

Signed projects as at 31 December 2000 (in € million), exchange rates as at 31 December 2000

Operation name	Sector	Total cost	EBRD debt	EBRD equity	EBRD total
Private sector					
IMGB/FECNE	Industry	65.0	0	5.2	5.2
Romanian Telecom	Telecommunications	549.2	142.0	0	142.0
Mobifon Romania GSM	Telecommunications	706.7	107.5	0	107.5
RomTelecom Transition Project	Telecommunications	706.7	107.5	0	107.5
Mobifon Romania GSM – Phase II	Telecommunications	167.0	8.2	0	8.2
EPH Grain Handling Terminal	Transport	25.2	8.6	0	8.6
Alpha Bank (formerly Bank of Bucharest)	Finance	4.4	0	1.6	1.6
Alpha Bank (formerly Bank of Bucharest) equity investment	Finance	18.6	0	1.8	1.8
Bank Post Convertible Loan	Finance	10.8	10.8	0	10.8
Banca Agricola IT	Finance	18.9	7.3	0	7.3
Romanian Development Bank Project	Finance	84.0	53.7	0	53.7
Romanian Development Bank Project	Finance	8.3	8.3	0	8.3
Commercial Bank Ion Tiriac	Finance	9.3	0	7.0	7.0
Commercial Bank Ion Tiriac, Standby	Finance	21.5	21.5	0	21.5
Ion Tiriac Bank Capital Increase	Finance	22.0	10.7	10.8	21.5
Bankcoop	Finance	21.5	5.8	0	5.8
Capital SA	Finance	6.7	0	2.0	2.0
Energy Conservation and SME credit line	Finance	13.7	9.4	0	9.4
Banca Transilvania SME Facility	Finance	5.4	5.4	0	5.4
Privatisation of Romanian Development Bank	Finance	237.3	0	20.5	20.5
Romanian Post Privatisation Fund	Venture capital	49.4	0.8	15.4	16.2
Danube Fund	Venture capital	19.7	0	3.4	3.4
Athenée Palace Hotel	Tourism	65.8	15.3	0	15.3
Italian-Romanian Industrial Development Enterprise	Industry	33.3	8.4	2.2	10.6
Samsung MPF – Otelinox	Industry	77.8	0	19.3	19.3
Coca Cola Bottlers, Iasi & Oradea	Industry	26.9	5.4	0	5.4
EMCOM – Siemens	Industry	25.6	7.5	0	7.5
Virolite	Industry	39.2	11.9	3.7	15.6
Virolite Extension	Industry	4.3	2.2	0	2.2
Prompt SA	Industry	9.8	0	3.1	3.1
Arctic Privatisation and Modernisation	Industry	48.5	7.5	6.5	14.0
MPF Lafarge: Romcim	Industry	187.4	0	69.9	69.9
Sical	Industry	74.8	9.0	0	9.0
Danone MPF – Danone SRL	Agribusiness	25.7	0	7.2	7.2
Leventis Extension	Agribusiness	24.2	4.6	0	4.6
Parmalat MPF	Agribusiness	15.0	5.2	0	5.2
Agribusiness Development Project	Agribusiness	75.2	75.2	0	75.2
Banca Agricola Credit Line Extension	Agribusiness	53.7	16.1	0	16.1
Rompak	Agribusiness	32.8	8.1	0	8.1
United Romanian Breweries – Bereprod	Agribusiness	115.0	29.8	0	29.8
Dalkia ESCO Romania	Power & energy	27.4	4.7	2.4	7.1
Suez-Lyonnaise MPF Timisoara Water Concession Project	Infrastructure	54.3	24.7	0	24.7
Victoria office building	Construction	34.5	8.2	0	8.2
Fibrex	Textiles	32.2	10.0	0	10.0
Subtotal		3,854.7	761.3	182.0	943.3

continued

Signed projects as at 31 December 2000 (in € million), exchange rates as at 31 December 2000, continued

Operation name	Sector	Total cost	EBRD debt	EBRD equity	EBRD total
Public sector					
European Roads Rehabilitation	Infrastructure	512.1	86.0	0	86.0
Municipal Utilities Development Programme I	Infrastructure	75.9	30.1	0	30.1
Municipal Utilities Development Programme II	Infrastructure	201.7	80.6	0	80.6
Regional Water and Environment	Infrastructure	47.7	17.2	0	17.2
MELF: Subproject Constanta	Infrastructure	100.4	20.0	0	20.0
Eurovision Romania	Media	1.8	1.1	0	1.1
SNCFR – Railway Restructuring	Transport	451.3	78.0	0	78.0
Bucharest -Pitesti Motorway	Transport	111.1	57.1	0	57.1
NAR Restructuring & Road Rehabilitation	Transport	618.8	92.3	0	92.3
Operational Efficiency Improvement Project – Power Sector	Power & energy	141.2	78.1	0	78.1
Thermal Energy Conservation	Power & energy	90.9	48.4	0	48.4
National Power Grid Company	Power & energy	219.7	55.3	0	55.3
Petroleum Pilot Modernisation	Natural resources	39.6	29.4	0	29.4
Bucharest Wholesale Market	Agribusiness	38.4	26.9	0	26.9
Subtotal		2,650.6	700.5	0	700.5
Signed projects total		6,505.3	1,461.8	182.0	1,643.8
of which private					57%
of which public					43%

Notes